

Message Text

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ACTION EUR-12

INFO OCT-01 ISO-00 SP-02 AID-05 EB-07 NSC-05 CIEP-01

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FM AMEMBASSY PARIS

TO SECSTATE WASHDC 1157

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PASS TREASURY AND FEDERAL RESERVE

E.O. 11652: N/A

TAGS: EFIN, FR

SUBJECT: THE FRANC REJOINS THE "SNAKE" AMID GROWING
DOUBTS ABOUT PROSPECTS FOR THE FRANC IN 1976

1. SUMMARY. THE DECISION TO REJOIN THE EC MONETARY
"SNAKE" WAS TAKEN BY THE PRESIDENT OF FRANCE FOR
POLITICAL REASONS, ALMOST CERTAINLY WITHOUT THE CONCUR-
RENCE OF THE "TECHNICAL" LEVEL AT THE MINISTRY OF
FINANCE AND THE BANK OF FRANCE. DOUBTS ARE GROWING BOTH
IN PARIS AND ABROAD ABOUT THE PROSPECTS FOR THE FRANC
WITHIN THE "SNAKE," PARTICULARLY IN 1976.
THE PRIVATE VIEWS OF SENIOR OFFICIALS AT THE MINISTRY OF
FINANCE AND BANK OF FRANCE ABOUT THE ECONOMY HAVE BECOME
NOTICEABLY MORE PESSIMISTIC IN RECENT WEEKS. YET THE
"SNAKE" WILL EXERT A DISCIPLINE THAT PROBABLY WILL PRE-
CLUDE THE FULL USE OF MONETARY POLICY TO HELP REFLATE
THE ECONOMY. MOREOVER, IF THE FRANC HAS TO BE SUPPORTED
NEXT YEAR IN ORDER TO REMAIN IN THE "SNAKE," ANY
CONCEIVABLE ADVANTAGE FROM HAVING REJOINED IT WOULD BE
QUICKLY DISSIPATED. END SUMMARY.

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2. THE FRANC FORMALLY REJOINED THE EC MONETARY "SNAKE"

JULY 10. FROM A TECHNICAL VIEWPOINT, THERE ARE GROWING DOUBTS BOTH IN PARIS AND ABROAD THAT THE FRANC WILL BE ABLE TO SUSTAIN ITS POSITION IN THE "SNAKE" IN 1976. THESE DOUBTS ARE BASED ON THE VIEW THAT THE APPRECIATION OF THE FRANC OVER THE PAST YEAR RESULTED PRIMARILY FROM LONG-TERM FOREIGN BORROWING, WHICH CREATED DEMAND FOR FRANCS IN THE EXCHANGE MARKET AND WHICH CANNOT LAST INDEFINITELY. ADDITIONALLY, IN THIS VIEW THE BALANCE OF PAYMENTS IMPROVEMENT ON CURRENT ACCOUNT IS CYCLICAL, INVOLVING A SHARP DROP IN IMPORTS WITH OVERALL LEADS AND LAGS TEMPORARILY SUSTAINING EXPORTS (PARTICULARLY TO WEST GERMANY AND BENELUX) WHICH NOW MAY HAVE BEGUN A DECLINE ALMOST AS PRECIPITOUS AS OCCURRED EARLIER ON THE IMPORT SIDE. THIS VIEW IS REINFORCED BY THOSE WHO BELIEVE THAT THE FRENCH ECONOMY IS SHAKY (REF EC BRUSSELS 6232). THUS THE POSSIBILITY OF A MORE EXPANSIONARY ECONOMIC POLICY LATER ON COULD CAUSE A CONSIDERABLE CHANGE IN THE PROSPECTS FOR THE FRANC IN THE EXCHANGE MARKETS NEXT YEAR.

3. JUST PRIOR TO AND AFTER THE ANNOUNCEMENT OF THE DECISION TO REJOIN THE "SNAKE," CONVERSATIONS WITH SENIOR OFFICIALS AT THE MINISTRY OF FINANCE AND THE BANK OF FRANCE STRONGLY SUGGESTED THAT IF IT WERE THEIR DECISION, FRANCE WOULD NOT HAVE REJOINED THE "SNAKE." UNTIL THE ANNOUNCEMENT TO REJOIN THE "SNAKE" WAS MADE, THE FRENCH TREASURY WAS ANTICIPATING A LOWERING OF INTEREST RATES CONSISTENT WITH A PROGRAM TO GRADUALLY REFLATE THE ECONOMY. GIVEN THE REASONS FOR THE FRANC'S RECENT STRENGTH, IT IS OBVIOUS THAT FRENCH INTEREST RATES MUST REMAIN RELATIVELY HIGH IN ORDER TO SUSTAIN THE RELATIVE POSITIONS OF THE FRANC AND THE D-MARK WITHIN THE "SNAKE." THE IMPLICATIONS OF THIS POSTURE FOR DOMESTIC ECONOMIC POLICY ARE EQUALLY OBVIOUS.

4. WITH THE FRENCH ECONOMY STILL FAR FROM RECOVERY AND INFLATIONARY PRESSURES STILL STRONG, THE QUESTION REMAINS WHY THE PRESIDENT OF FRANCE DECIDED TO HAVE THE FRANC REJOIN THE "SNAKE." NO ONE WAS SUGGESTING THAT LIMITED OFFICIAL USE
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FRANCE REJOIN THE "SNAKE." SUCH AN ANNOUNCEMENT COULD HAVE BEEN MADE AT ANY TIME FOR EXAMPLE, NEXT YEAR ASSUMING THAT OFFICIAL FORECASTS OF AN IMPROVED ECONOMY WITH MUCH LESS INFLATION AND A STABLE FRANC ARE REALIZED AS THE RESULT OF ONGOING ECONOMIC POLICIES OF RELATIVE RESTRAINT. THE ANNOUNCEMENT CLEARLY ANTICIPATED A SUCCESS NOT YET CERTAIN. THE FACT THAT IT WAS MADE ON THE 25TH ANNIVERSARY OF THE FOUNDATION OF THE EUROPEAN COAL AND STEEL AGREEMENT -- THE PROTEAN COMMON MARKET -- WAS SYMBOLIC. THUS, THE DESIRE TO

FACILITATE A COMMON MONETARY POSTURE BY THE EC,
PARTICULARLY IN RELATION TO THE DOLLAR; THE PARTICULAR
DESIRE OF PRESIDENT GISCARD D'ESTAING TO HAVE THE

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FRANC MORE OR LESS EQUIVALENT TO THE D-MARK; AN EXPLICIT
EXPRESSION OF CONFIDENCE IN THE FRENCH ECONOMY AND THE
FRENCH ROLE IN THE EC AND THE FUTURE OF WESTERN EUROPE,
INCLUDING THE EVENTUAL CONSTRUCTION OF MONETARY AND
ECONOMIC UNION PROBABLY ALL PLAYED A PART IN THE
DECISION TO REJOIN THE "SNAKE." IN ANY CASE, IT
CERTAINLY WAS CONSISTENT WITH THE IMAGE THAT THE
PRESIDENT OF FRANCE WISHES TO CONVEY AT HOME AND IN
WORLD AFFAIRS. FOR THESE REASONS VIRTUALLY EVERYONE
HAS CONCLUDED THAT THE DECISION TO REJOIN THE "SNAKE"
WAS POLITICAL, BUT VIEWS ARE DIVIDED AS TO WHETHER IT
WAS MERELY TACTICAL OR PART OF SOME GRAND DESIGN.

5. WHETHER IT WAS STRATEGIC OR TACTICAL, A FRANC
THAT WOULD REQUIRE ASSISTANCE TO REMAIN IN THE
"SNAKE" WOULD QUICKLY NEGATE ANY CONCEIVABLE ADVANTAGE

DERIVED FROM REJOINING IT. THUS IT SEEMS ALMOST CERTAIN THAT PRESIDENT GISCARD D'ESTAING REJECTED THE VIEWS OF THOSE WHO QUESTION THE PROSPECTS FOR THE FRANC WITHIN THE "SNAKE." THIS DECISION ALSO DISCOUNTED THE VIEW THAT SIGNIFICANT CHANGES IN DOMESTIC LIMITED OFFICIAL USE

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ECONOMIC POLICY MAY YET BE REQUIRED.

6. MEANWHILE COMMENTS ON THE PROBABLE RESULTS OF THE FRENCH ECONOMY IN 1975 BY SENIOR MINISTRY OF FINANCE AND BANK OF FRANCE OFFICIALS HAVE BECOME MORE PESSIMISTIC SINCE LAST MAY. A RANGE OF MINUS 1.5 PERCENT TO PLUS 1 PERCENT IS NOW THEIR PRIVATE CONSENSUS FOR REAL GROWTH IN 1975 WITH UNEMPLOYMENT PEAKING AT 1 MILLION OR SLIGHTLY MORE IN THE FALL. IF THE GOF DECIDES TO STIMULATE THE ECONOMY AS THE RESULT OF THESE DEVELOPMENTS, IT PROBABLY WOULD HAVE TO RELY ON FISCAL MEASURES POSSIBLY SUPPLEMENTED BY SELECTIVE CREDIT CONTROLS BECAUSE THE DISCIPLINE IMPOSED BY THE SNAKE ON THE EXCHANGE RATE PROBABLY WOULD PRECLUDE A REDUCTION IN INTEREST RATES RELATIVE TO OTHER MAJOR INDUSTRIAL COUNTRIES. FRENCH MONETARY AUTHORITIES PROBABLY ARE HOPING FOR A STRENGTHENING OF THE DOLLAR, ESPECIALLY VIS A VIS THE D-MARK, FOR MORE THAN JUST TRADE REASONS.

7. THE PROSPECTS FOR THE FRANC WITHIN THE "SNAKE" SEEM ASSURED UNTIL THE FALL WHEN CURRENT ECONOMIC POLICIES OF RELATIVE RESTRAINT MAY HAVE TO BE MODIFIED. AFTER THAT THE PROSPECTS ARE MUCH LESS CERTAIN. IN ANY EVENT THE UNDERLYING CAUSES FOR 12 CONSECUTIVE MONTHS OF FRANC APPRECIATION SEEM TO HAVE JUST ABOUT RUN THEIR COURSE. IF GOF PROJECTIONS FOR THE ECONOMY ARE REALIZED, THE FRANC EXCHANGE RATE SHOULD REMAIN RELATIVELY STABLE FOR SOME TIME TO COME, BUT DOUBTS ARE GROWING AND THE FRANC MIGHT WELL MOVE INTO A MORE OR LESS STEADY TENDENCY TO DEPRECIATE IN 1976. IF SO, THE APPARENTLY IMPETUOUS AND CERTAINLY UNEXPECTED DECISION TO REJOIN THE "SNAKE" WILL DEFINITELY NOT ADD LAURELS TO GOF ECONOMIC POLICY.
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